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SUBJECT: GDRC STABILIZES CURRENCY MARKET--BUT RISKS REMAIN

REF: (A) KINSHASA 520
(B) KINSHASA 479
(C) KINSHASA 331
(D) KINSHASA 317

¶1. (U) Summary: Following a rapid depreciation of the Congolese Franc (franc congolais or FC, in French) in late 2008/early 2009, the government of the Democratic Republic of Congo (GDRC) has successfully helped stabilize the FC through a series of interventions in the foreign exchange market. Specifically, the Central Bank (Banque central du Congo or BCC, in French) launched a bi-monthly foreign exchange auction program in early April aimed at stopping the FC's slide by mopping-up excess liquidity and increasing demand for the local currency. Since launching the auctions, the FC has appreciated 9.63 percent. The BCC's auction program was made possible due to the augmentation of international reserves following the approval in March 2009 of USD 200 million through the IMF's Emergency Shocks Facility (ESF) and other international emergency financial assistance (Refs A-D). An additional positive development has been a recent slowing of inflation, which had increased rapidly as the currency weakened. The strengthened franc and lower inflation are good news for the average Congolese, whose already low purchasing power had been significantly undermined. While the BCC plans to continue the auction program in the near-term, these positive trends will also require continued tight monetary and fiscal policies, including a particular focus on public spending. End summary.

CONGOLESE FRANC SLIDES AS FINANCIAL CRISIS HITS
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¶2. (U) As noted in Ref C, one of the most visible signs of the deteriorating economic situation in the DRC as a result of the global financial crisis has been the steady depreciation of the local currency. Prior to the final quarter of calendar year 2008, the GDRC's tight monetary policy had successfully kept the FC stable for two years, at a rate of approximately FC 550 against the dollar. Starting in late 2008, however, the FC began to steadily lose value, a trend that continued through early 2009. Annual depreciation of the FC in 2008 was 27.3 percent; from January to mid-June, 2009, the FC depreciated by 19.34 percent. In early January, the FC's depreciation rapidly accelerated-losing 12 percent of its value during a 24 hour period alone, the largest percentage loss of value in one day in over seven years.

¶3. (U) Beginning in December 2008, the GDRC began to intervene in the foreign exchange market to reduce excess liquidity (estimated by the Central Bank at FC 57 billion at the end of March, 2009). The BCC used two principal instruments: raising interest rates and injecting US dollars into the local market. The BCC raised interest rates a total of three times in early 2009, from 28 percent to the current rate of 65 percent. In addition, the BCC injected over USD 16 million into the local market during two separate interventions: USD 10 million in mid-January and USD 6 million in mid-February.

While these measures-in particular, the injection of US dollars into the local market-temporarily helped strengthen the FC, the overall trend continued. At the end of March,2009, just before the BCC began its new auction program, the official exchange rate was 838 FC/USD and the parallel rate was 831 FC/USD. With reserve levels at close to zero during the first quarter of 2009 (Ref D), the GDRC had limited tools left to stabilize the currency.

GOVERNMENT INTERVENES AGAIN - THIS TIME IT WORKS

¶4. (U) Emergency financial assistance provided by the IMF, World Bank, European Union and African Development Bank (Refs A and B) in early 2009 provided the GDRC with the ability to undertake additional interventions in the foreign exchange market, this time through a new mechanism to purchase local currency through an auction program with local commercial banks. Beginning in mid-April 2009, and in coordination with the IMF, the BCC initiated a bi-monthly auction with commercial banks for the trading of foreign exchange aimed at reducing the liquidity of FC on the local market. During the first auction on April 13, the BCC made available USD 10 million; however, commercial banks acquired only USD 6 million. Two days later, the Central Bank sold the remaining dollars to the commercial banks. For the second auction of April 27, BCC offered USD 15 million, of which the commercial banks purchased USD 11.16 million. Seven commercial banks participated in the first two auctions. During the third auction, the Central Bank offered USD 10 million, of which commercial banks acquired USD 8.7 million. Eight commercial banks participated. During the most recent auction on May 27, the BCC offered USD 9 million, which was completely acquired by nine commercial banks.

¶5. (U) The auctions have been successful in stabilizing the currency, though perhaps less quickly than initially anticipated: following the fourth action of May 27, the official exchange rate was FC 785.1854 per USD, and the parallel market rate was FC 810 per USD. The GDRC plans to continue the bi-monthly auctions as long as necessary to continue to stabilize the currency.

BUT RISKS REMAIN

¶6. (SBU) While the BCC's foreign exchange auction program has been key in helping to stabilize the FC over the past two months, several risks remain. First and foremost, the government must avoid injecting new cash into circulation. In fact, the government has officially frozen non-priority spending, and all public spending must first have a corresponding revenue. (Note: Post will report septel on President Kabila's recent directive to Prime Minister Muzito that all public spending must now be approved by the President. End Note) Central Bank Governor Masangu has publically acknowledged that the GDRC's fiscal deficit at the end of 2008 (in other words, before international emergency assistance was approved) was the result both of public spending and the impact of the global financial crisis. To date, the GDRC has not resorted to printing money or issuing the long anticipated larger FC notes. However, there remain significant fiscal pressures, including continuing concerns over the government's ability to pay salaries, a recently launched USD 1.2 billion stabilization plan for Eastern DRC, and financial commitments for planned local elections in 2009. These fiscal pressures will increase if the approval of a formal IMF program (Poverty Reduction and Growth Facility, PRGF) slips and a first PRGF disbursement does not arrive during 2009 (Refs A, B, D).

¶7. (U) Comment: There is a longstanding and close correlation between exchange rate fluctuations and consumer price developments in the DRC. Increasing inflation accompanied by the rapidly depreciating FC in late 2008/early 2009 had rapidly deteriorated the average Congolese's already low purchasing power. A leading teacher's union (SYECO, Le Syndicat des enseignants du Congo, in French) recently called on the GDRC to index salaries to the US dollar to address what had been teachers' "shrinking" salaries in

light of macroeconomic developments. While such actions are unlikely, it highlights that while the recent strengthening and stabilization of the currency and accompanying declining inflation are positive developments, the economic downturn continues to significantly impact ordinary Congolese. This could impact the political situation, but it is impossible to know at this time when (or if) that might happen. End comment.

BROCK